No. 11804.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

KENNEDY NAME PLATE COMPANY, a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Review of the Decision of the Tax Court of the United States.

REPLY BRIEF FOR PETITIONER.

PRESTON D. OREM,
811 Chapman Building, Los Angeles 14,
Attorney for Petitioner.

Parker & Company, Law Printers, Los Angeles. Phone TR. 5206.

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As respondent states (Br. 9), the question presented is one of fact, and if there is substantial evidence to support the Tax Court's findings and decision, they should be affirmed on review. Provided, of course, that the provisions of the Administrative Procedure Act have been complied with below by the Tax Court.

The respondent argues (Br. 9), that the bonuses "actually represented corporate earnings" and, therefore, "were in fact distributions of profits." Of course, the bonuses, as well as the salaries of the officers, were paid from "corporate earnings." From what else could they be paid? The fact that bonuses were paid from "corporate earnings" does not make them dividends or distributions of profits.

The respondent states (Br. 13), "upon the Commissioner's determining what portion of the increased amount

paid the taxpayer's two officers constituted reasonable compensation for the services actually rendered by them, the taxpayer can prevail only upon a showing that the evidence fairly establishes that the claimed larger amounts were reasonable under all the circumstances, that such amounts were intended and paid as compensation for services, and that the extra compensation was such as would ordinarily have been paid by similar corporations or business enterprises to corresponding officers or employees for like services under like circumstances."

Respondent has fairly met these tests. On page 6 of respondent's brief there appears a schedule showing the taxpayer's net sales, officer's compensation, net income, federal taxes on income and net profits, all for the years 1936 to 1942. The increases in volume of sales and net profits alone should support the increase in the officer's salaries to what was, after all, moderate compensation in view of the long experience of the officers in the industry, the long hours they worked, and the fact that the entire responsibility on the management of the company rested upon their shoulders. The bonuses were *intended and paid for services,* as shown by the minutes of the board of directors of petitioner (Br. 6). There is absolutely nothing in the record to support a statement that the bonuses paid by petitioner to its officers were not made in good faith and as additional compensation for services actually rendered. *Capitol-Barg Dry Cleaning Co. v. Commissioner*, 131 F. (2d) 712. The extra compensation was such as would ordinarily have been paid by similar corporations or *business enterprises* to corresponding officers or employees for like services under like circumstances. This statement is well supported by the testi-

mony of Charles W. Miller, a disinterested and competent witness, whose testimony was uncontradicted, and The Tax Court cannot arbitrarily disregard such evidence. *Capitol-Barg Dry Cleaning Co. v. Com., supra.* Charles W. Miller was a partner in the principal competitor of petitioner. The fact that Mr. Miller's business form of operation was a partnership, instead of a corporation is immaterial under respondent's own statements and regulations. In respondent's summary of argument (Br. 9), he refers to "like enterprises" as presenting a proper basis of comparison, and in his regulation on the subject he refers to "like services by like enterprises under like circumstances" (Br. 28).

On page 17 of respondent's brief, he states:

> "The evidence shows that the taxpayer's business was materially enhanced to unprecedented proportions during the taxable years by the manufacture and sale of war materials."

Respondent advances this fact as an argument for restriction of the compensation of petitioner's officers. The Tax Court in this case does not base its decision on this point. In fact the Tax Court, itself, in *North Carolina Equipment Co. v. Com.,* memorandum decision of the Tax Court, Docket No. 4737, entered June 4, 1945, allowed a salary of $6,900.00, plus an additional compensation of $95,353.61 to the president of taxpayer as compensation for the year 1941, stating,

> "we think it is of no importance that war conditions in a measure enhanced the profits of petitioner corporation in 1941."

In this case, petitioner was engaged in erection of military camps and war projects.

Respondent respectfully differs with the argument of petitioner that the case of *Capitol-Barg Dry Cleaning Co. v. Com., supra,* should be disregarded upon appeal because it was decided erroneously (Br. 22) and it is inconsistent with the decision of this Court in the case of *Doernbacher Mfg. Co. v. Com.,* 95 F. (2d) 296. The *Capitol-Barg* case represents a well-reasoned decision of the Sixth Circuit Court, which must have been accepted by the Commissioner as certiorari was not applied for. The *Doernbacher* case offers no points of similarity to either the *Capitol-Barg* case or the case on appeal herein. But the facts in the *Capitol-Barg* case are strikingly similar to those before the Court in this appeal.

Respecting the applicability of the Administrative Procedure Act to the review of the decisions of the Tax Court, the respondent for the information of the Court submits as an Appendix to this brief, the complete article entitled "The Administrative Procedure Act and the Tax Court" from "Taxes," the tax magazine of Commerce Clearing House, Inc., for the month of March, 1948, appearing in that magazine at page 255, *et seq.*

Petitioner reiterates its contentions in its opening brief as to the applicability of the Administrative Procedure Act to the Tax Court. *Lincoln Electric Co. v. Commissioner,* 162 F. (2d) 379 (C. C. A. 6th).

Respondent's contention that the granting or refusing of motions such as the motion of petitioner herein to the Tax Court to vacate and set aside the memorandum findings of fact and opinion is "solely within the sound dis-

cretion of the Tax Court" is in error (Br. 23). It is true that a motion for rehearing is within the discretion solely of the presiding judge of the Tax Court. But petitioner's motion to vacate is of a different type. It goes to the compliance or non-compliance of the Tax Court to the provisions of the Administrative Procedure Act.

Petitioner on June 10, 1947, filed a motion to vacate and set aside the findings and opinion of the Tax Court on the ground that the Tax Court is an "agency" governed by the Administrative Procedure Act, and petitioner had no opportunity, as required by that Act, to submit its objections and exceptions to the Tax Court's "initial" decision before it became final [Tr. pp. 66-67]. The Tax Court denied this motion [Tr. p. 68].

Section 7(a) of the Administrative Procedure Act provides that cases may be heard by: "(1) the agency; (2) one or more members of the body which comprises the agency, or (3) one or more examiners appointed as provided in this Act." Section 8(a) provides that in cases where the agency itself has not presided at the reception of the evidence the officer who presided shall make an initial or recommended decision, from which there shall be an opportunity for appeal to, or review by, the agency. Section 8(b) provides that a party shall have an opportunity to submit exceptions to the decision or recommended decision of the hearing officer prior to agency review. On this phase of the Act the Attorney General's interpretation is as follows (Senate Document No. 248, 79th Congress, 2nd session—Legislative History, Administrative Procedure Act—at page 229):

> "Section 8(b): Prior to each recommended, initial, or tentative decision parties shall have a timely

opportunity to submit proposed findings and conclusions, and prior to each decision upon agency review of either the decision of subordinate officers or of the agency's tentative decision, to submit exceptions to the initial, recommended, or tentative decision, as the case may be. * * *"

Since the Tax Court judge who heard this case is a member "of the body which comprises the agency," rather than the agency itself, petitioner was entitled, under the above provisions of the Act, to file exceptions to his report, and to opportunity for review by, or on behalf of, the Tax Court itself. Because the Tax Court takes the erroneous position that it is a court rather than an agency, petitioner was accorded neither of these rights. This denial is clearly reversible error under section 10(e)(B) of the Administrative Procedure Act which directs reviewing courts to "hold unlawful and set aside agency action, findings, and conclusions found to be * * * (4) without observance of procedure required by law."

As stated in respondent's brief (Br. 24) the Sixth Circuit held that the Administrative Procedure Act has broadened the power to review the Tax Court's decisions. *Lincoln Electric Co.* case, *supra.* This decision is clearly correct. Section 10(e)(B)(5) is fully discussed in petitioner's opening brief, at pages 23 to 26. It is a forceful adoption of the rule that substantial evidence "is more than a mere scintilla." *Consolidated Edison Co. v. N. L. R. B.,* 305 U. S. 209, 229. Clearly under this subsection, the functions of the reviewing court are not limited to a mere search of the record to see if the burden of evidence lacks any iota of reliable evidence. Courts under the section will be required to base their judgment on review

of the entire record or so much of it as may be cited by any party.

Respondent in his brief at page 25 peculiarly argues that although the Tax Court "is not legally or technically a court, it is clear from the provisions of that Act (the Administrative Procedure Act) * * * that it is not an 'agency' to which Section 8 or any other section of the Act applies." Respondent does not back up the foregoing statement by any authority. If the Tax Court is neither a "Court" or an "Agency," what is it? The Sixth Circuit has rightfully held that it is an agency, subject to the Administrative Procedure Act. *Lincoln Electric Co.* case, *supra.*

As respondent states (Br. 24-25), Congress prior to the enactment of the Administrative Procedure Act had already specified the manner in which the decisions of the Tax Court should be reviewed. Sections 1141-1142 of the Internal Revenue Code. Section 12 of the Act provides, among other things, that:

> "(1) Nothing in this Act shall be held—(a) to diminish the constitutional rights of any person. (b) to limit or repeal additional requirements imposed by statute or otherwise recognized by law."

Thus the complete law with respect to appeal now consists of the new law (Administrative Procedure Act) plus the old law (Internal Revenue Code). This is a complete answer to respondent on this point.

If it is thought that for some reason the Tax Court should be exempted from the requirements of the Administrative Procedure Act, this exemption is the function of Congress, rather than that of the courts. Merely because

the requirements of the Act change the procedures of the Tax Court and amplify the rights of taxpayers on appeal is no *reason whatever* to by "judicial legislation" nullify the provisions of the Administrative Procedure Act as applied to the Tax Court. Congress itself realizes that a new bill is necessary to remove the Tax Court from the operations of the Administrative Procedure Act (see Congressional Record, July 7, 1947, pp. 8850 *et seq.*).

Conclusion.

The decision of the Tax Court should be reversed as not in accordance with the law or as unsupported by the evidence, or, in the alternative, the decision should be reversed and the case remanded to the Tax Court of the United States for such other and necessary procedure under the Administrative Procedure Act as the case may require.

Respectfully submitted,

PRESTON D. OREM,

Attorney for Petitioner.

APPENDIX.

The Administrative Procedure Act and the Tax Court.

The Administrative Procedure Act[1] became law on June 11, 1946, in answer to a "widespread demand for legislation to settle and regulate the field of Federal administrative law and procedure."[2] The Act was intended to have broad coverage, and such exemptions as it recognizes are in terms of functions rather than agencies as such.[3]

The purpose of this article is to examine whether the Tax Court is subject to the Administrative Procedure Act, and if so, what important consequences follow.

A. Does the Act Apply to the Tax Court?

The Administrative Procedure Act is concerned with administrative agencies. Section 2(a) of the Act defines "agency" to mean

> "each authority (whether or not within or subject to review by another agency) of the Government of the United States other than Congress, the courts, or the governments of the possessions, Territories, or the District of Columbia."

The Tax Court is accordingly subject to the Act if it is an "agency," but not if it is a "court," as those terms are used in this definition.

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[1]60 Stat. 237, 5 U.S.C. §1001 *et seq.*

[2]S. Rept., Legislative History, Administrative Procedure Act, Senate Document No. 248, 79th Cong., 2d sess. (hereinafter cited "Legis. Hist."), p. 187.

[3]H. R. Rept., Legis. Hist., p. 250.

The Tax Court is clearly not a court in any technical sense. The Tax Court's predecessor, the Board of Tax Appeals, was created by the Revenue Act of 1924[4] as "an independent agency in the executive branch of the Government." The Internal Revenue Code, when enacted, described the Board in the same way.[5]

The Supreme Court, in *Old Colony Trust Co. v. Commissioner, 279* U. S. *716, 725* said:

> "The Board of Tax Appeals is not a court. It is an executive or administrative board, upon the decision of which the parties are given an opportunity to base a petition for review to the courts after the administrative inquiry of the board has been had and decided."

The change of the Board's name to "Tax Court," and the designation of its members as "judges," in no way affected the status of the tribunal as an independent agency in the executive branch. The Committee Report,[6] explaining §504 of the Revenue Act of 1942[7] which effected the changes, says:

> "This section merely changes the names by which the Board of Tax Appeals, its chairman and its members are known. No change is made in its status. The Board, which will hereafter be known as the United States Tax Court, is continued as an inde-

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[4]43 Stat. 253, 338. The Board replaced a departmental Committee on Appeals and Review set up by the Commissioner of Internal Revenue. See H. R. Rept. 179, 68th Cong., 1st sess., pp. 7, 8; Williamsport Wire Rope Co. v. U. S., 277 U. S. 551, 562.

[5]§1100.

[6]H. R. Rept. No. 2333, 77th Cong., 2d sess., pp. 172, 173.

[7]56 Stat. 957.

> pendent agency in the executive branch of the Government. *Thus its status as an executive or administrative board is unchanged.* Old Colony Trust Co. v. Commissioner, 279 U. S. 716, 725 (1929). * * * The Board and its divisions will continue to have the same jurisdiction, powers, and duties as provided by existing law." (Emphasis added.)

In *Commissioner v. Gooch,* 320 U. S. 418, 420, the Supreme Court held that since the Board of Tax Appeals was but "an independent agency in the Executive Branch of the Government" it had no jurisdiction, such as an equity court might have, to apply a doctrine of equitable recoupment. And the Court pointed out[8] that the Board's change of name to Tax Court had "no effect on the jurisdiction, powers and duties of the *agency.*" A short time later, in *Hutchings-Sealy National Bank v. Commissioner,* 141 F. (2d) 422, the Fifth Circuit Court of Appeals held that the Tax Court, like the Board, was an agency rather than a judicial tribunal, so that it was unnecessary for an executor to seek formal substitution as a party on review of a Tax Court decision where the taxpayer died before the petition for review was filed.

Since the Tax Court is an agency rather than a court, it would seem to follow that, like other agencies, it is subject to the Administrative Procedure Act. This is true unless §2(a) of the Act, exempting "courts" from the Act's operation, uses the word in some special, esoteric sense; that is, unless Congress intended to exempt from the Act not only tribunals which are courts in fact but also an administrative agency which is called a court.

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[8]Footnote No. 1.

The Attorney General has expressed the view that the Tax Court is not subject to the Act. Commenting on the exemption of courts in §2, the Attorney General said, in a letter to Senator McCarran, Chairman of the Senate Judiciary Committee, while the bill was pending:

> "'Court' includes the Tax Court, Court of Customs and Patent Appeals, the Court of Claims and similar courts. This act does not apply to their procedure nor affect the requirement of resort thereto."[9]

The Attorney General does not indicate how he arrives at this conclusion with respect to the Tax Court. The Court of Customs and Patent Appeals and the Court of Claims are in quite a different category from the Tax Court. They are legislative courts of record provided for in the Judicial Code.[10] They have been so recognized by the Supreme Court.[11] Their judges, like the judges of constitutional courts, hold office during good behavior and retire with full pay.[12]

The Committee reports express an intention to exclude from the definition of "agency" in the Act only "legislative, judicial, and territorial authorities" and to include "any other 'authority.'"[13] Congress' intention to exclude "judicial authorities" from the operation of the Act would

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[9]Legis. Hist., p. 224.

[10]Secs. 188 and 136, as amended, Judicial Code; 28 U. S. C. 301, 241.

[11]*Ex Parte Bakelite Corporation,* 279 U. S. 438; *Williams v. United States,* 289 U. S. 553.

[12]28 U.S.C. 301a, 241, 375.

[13]Legis. Hist., pp. 196, 252.

appear not to extend to a body which it had previously set up as "an independent agency in the executive branch of the Government."[14] Indeed, agencies in the executive branch are precisely what the definition is designed to include.

In at least one point in the legislative history it seems to have been tacitly assumed that the Tax Court is among the agencies covered. In the debate on the Senate floor[15] the legislators were discussing §6(a) of the Act which deals with the right of persons appearing before agencies to be represented by counsel. A question was raised as to how far an agency might go in prescribing qualifications of persons eligible to appear as counsel before it. Senator Ferguson asked:

> "Let us consider the Tax Board [*sic!*]. Could the Board [*sic!*] itself determine that certain individuals were qualified to appear and that other persons were not qualified to appear?"

Senator McCarran, who sponsored the bill in the Senate, replied:

> "The answer to that question is 'No.' The Board [*sic!*] could not do so. The Board [*sic!*] would have to accept lawyers or non-lawyers as the case may be, because a tax expert may not be a lawyer."[15a]

Perhaps further light may be shed on the problem at hand by examining it against the principal objectives which

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[14]See *supra*, p. 2.

[15]Legis. Hist., p. 318.

[15a]Whether Senator McCarran's reply was in fact correct is a question which need not be considered here. *Cf.* Rule 2, "Rules of Practice before the Tax Court of the United States."

the Administrative Procedure Act was intended to accomplish.

The Act may be said to have three broad, major objections:[16] (1) to make available to the public, except where secrecy is required in the public interest, full information concerning the organization, procedures, rules, and orders of each agency (§3); (2) to prescribe certain minimum procedures and safeguards which each agency must observe in formulating its rules and decisions (sections 4, 5, 7, 8); (3) to define clearly the nature and extent of the right to judicial review of administrative determinations (§10).

It is hard to see why each of these principal objections does not apply as fully to the Tax Court as to other agencies. The Supreme Court in *Dobson v. Commissioner,* 320 U. S. 489, 501, for example, squarely placed judicial review of Tax Court decisions on the same footing as review of the decisions of other agencies. Speaking of the permissible scope of judicial review of Tax Court decisions, the Court emphasized that—

> "All that we have said of the finality of administrative determination in other fields is applicable to determinations of the Tax Court."

(It might also be noted that the Court throughout its opinion referred to the Tax Court as an "administrative body" and to its decisions as "administrative decisions.") It is true, of course, that there may be no occasion to invoke particular provisions of the Act in the case of the

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[16] *Cf.* S. Rept., Legis. Hist., pp. 193, 194; Sen. debate, *ibid.,* p. 304.

Tax Court.[17] The same may be said of many agencies.[18] It does not follow that the Act does not apply at all.

The Attorney General's Committee on Administrative Procedure, appointed in 1939 at the request of President Roosevelt to investigate the "need for procedural reform in the field of administrative law,"[19] made exhaustive studies covering most of the agencies in the executive branch. The results of its studies were published in a *Final Report*[20] and twenty-seven monographs which it prepared on individual agencies. The Board of Tax Appeals was one of the agencies which the Committee studied, and one of its monographs discusses the Board[21]. Nothing in the *Final Report* or the monograph indicates that the Committee regarded the Board as unique or outside its principal recommendations. The contrary would seem to be clearly true.[21a]

In preparing the bill which became the Administrative Procedure Act, careful attention was paid to the earlier work of the Attorney General's Committee.[22] A Senate

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[17]Examples are §9(b) dealing with licensing, and §5(c) relating to separation of functions between prosecuting and adjudicating officers.

[18]An extreme example is Said Elizabeth Hospital, Washington, D. C., which publishes its organization and procedures as required by §3 (11 Fed. Reg. 177 A-565), but is probably otherwise unaffected by the Act.

[19]See "Final Report of the Attorney General's Committee on Administrative Procedure," Sen. Doc. No. 8, 77th Cong., 1st sess., p. 1.

[20]Note 19, *supra.*

[21]Sen. Doc. No. 10, Part 9, 77th Cong., 1st sess., pp.69-83.

[21a]See Final Report, footnote 19, *supra,* p. 167.

[22]Committee Reports, Legis. Hist., pp. 190, 246.

Judiciary Committee "print" was issued showing the parallel between each provision of the new proposed law and the recommendations of the Attorney General's Committee.[23]

Had the name of the Board of Tax Appeals remained unchanged it would seem to be beyond serious dispute that the Administrative Procedure Act applied to it. But every reason for applying the Act to the tribunal were it still called a Board is equally present now that it is called a Tax Court, since the change in name did not make the tribunal any the less an agency or otherwise affect its functions.[24]

Viewing the Tax Court against this background of the statute creating it, and the history and purposes of the Administrative Procedure Act, it is reasonable to conclude that the Tax Court is among the agencies to which the Act applies, and that the Attorney General's "dictum" to the contrary is wrong.

The Sixth Circuit Court of Appeals reached this conclusion in the case of *Lincoln Electric Company v. Commissioner,* 162 F. (2d) 379, decided on June 5, 1947. The *Lincoln Electric* case involved the deductibility as "ordinary and necessary expenses" of premiums paid upon an employees' retirement annuity policy and payments to a trust for the benefit of employees. The Tax Court decided that the expenditures were not "ordinary and neces-

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[23]Legis. Hist., p. 11 *et seq.*

[24]See *supra,* pp. 2, 3. Suppose that the name of the Board of Tax Appeals had been changed to "Tax Court" after passage of the Act. Surely, the Act at its inception would have applied to the Board and would not have ceased to apply because of the change in name.

sary" and the Commissioner argued that this was a factual determination binding on the Court of Appeals under the *Dobson* rule.[25] The Court of Appeals rejected this argument and reversed the Tax Court, holding that the question before it was one of law which *Dobson* did not preclude it from reviewing. But the Court of Appeals went further and held that, in any event, the permissible scope of review would be fixed by the Administrative Procedure Act rather than by the Dobson rule, since it found the Tax Court to be an agency subject to the Act. The Appellate Court found it unnecessary, on the facts before it,

> "to particularize in what respect our power to review has been enlarged, except to say that it doubtless has been broadened and that it will be time enough to consider the precise application of the Act when clear-cut questions of fact and law are brought to us for review."

In *Dawson v. Commissioner,* ..... F. (2d) ..... (decided September 22, 1947), a family partnership case, the Sixth Circuit Court reaffirmed what it had said in the *Lincoln Electric* case with respect to the Administrative Procedure Act, but found that it would reach the same conclusion (affirming the Tax Court) irrespective of the standard of review applied.

The Seventh Circuit Court of Appeals, in *Anderson v. Commissioner* (decided December 17, 1947), recently expressed disagreement with the Sixth Circuit's *Lincoln Electric* case. The Tax Court had held that certain intra-

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[25]*Dobson v. Commissioner,* 320 U. S. 489.

family transfers of stock did not constitute *bona fide* gifts so that the income remained taxable to taxpayers, the purported donors. On appeal, the taxpayers argued that, because of the Administrative Procedure Act, the *Dobson* rule should not apply to this finding. The Seventh Circuit, affirming the Tax Court said that the evidence supported the Tax Court's decision under any theory of judicial review, and then added gratuitously that it disagreed with the *Lincoln Electric* case anyway. As to the extent of disagreement, however, it is not clear whether the Seventh Circuit felt that the Tax Court was not an agency subject to the Act at all, or whether it merely disagreed with the Sixth Circuit's view that if the Act applied, *Dobson* no longer would.

Assuming, however, the correctness of the Sixth Circuit's view that the Act applies to the Tax Court, the next question is what consequences follow.

B. The Consequences.

The consequences of applying the Act to the Tax Court may be viewed in relation to the Act's three broad objectives set out above; that is: (1) Public information; (2) procedural safeguards, and (3) clarification of the nature and extent of judicial review.

1. Public Information.

Section 3 of the Act requires each agency to publish in the Federal Register a description of its central and field organization, statements as to its forms and procedures, and its substantive rules. It also provides that no person need resort to organizational or procedural rules not so

published. The Tax Court has not complied with this section of the Act because it has not regarded itself as subject to the Act. If it is finally held subject to the Act, it will of course have to publish the prescribed materials.

2. Procedures.

Tax Court hearing procedures are prescribed by sections 1111 through 1119 of the Internal Revenue Code. A "division" of the Court, consisting of one or more judges, hears cases and reports its determinations.[25a] The report of the division becomes the report of the Court after 30 days, unless within that time the presiding judge directs that the report be reviewed by the Court.[26]

The Administrative Procedure Act provides that presiding officers at hearings shall consist of: (1) the agency; (2) one or more members of the body which comprises the agency, or (3) one or more hearing examiners appointed as provided for in the Act.[27] Section 8(a) provides alternate methods by which an agency may formulate a decision. The hearing officer may make the initial decision which, in the absence of an appeal to the agency, or review upon motion of the agency, becomes the agency decision. Or the officer who heard the case may instead recommend a decision, and the agency will itself make the initial decision (which is also the final decision). Whichever method the agency chooses to follow, it must observe the

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[25a]§1114(b) provides that "the presiding judge may from time to time by written order designate an attorney from the legal staff of the court to act as a commissioner in a particular case." This procedure is seldom used.

[26]Sections 1103, 1118, Internal Revenue Code.

[27]Section 7(a).

procedures laid down in section 8(b) which provides that—

> "Prior to each recommended, initial, or tentative decision, or decision upon agency review of the decision of subordinate officers the parties shall be afforded a reasonable opportunity to submit for the consideration of the officers participating in such decisions (1) proposed findings and conclusions, or (2) exceptions to the decisions or recommended decisions of subordinate officers or to tentative agency decisions, and (3) supporting reasons for such exceptions or proposed findings or conclusions. The record shall show the ruling upon each such finding, conclusion, or exception presented. * * *"

The Act therefore contemplates that whenever the agency does not itself hear a case, the officer who heard it shall write an intermediate opinion from which an appeal or review within the agency shall be available.

As noted above, the Act[28] makes a distinction between (1) the agency, and (2) members of the body which comprises the agency. Accordingly, a Tax Court judge who hears a case is not the agency; he is a member of the body which comprises the agency. While, under section 8, the intermediate report procedure is not required when the agency itself hears the case, it is required when the case is heard by one or more members of the body which comprises the agency. It is therefore required in the usual Tax Court case.

Of course no such procedure as section 8 prescribes is observed in the Tax Court. A party receives no tentative

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[28]Section 7(a).

or intermediate opinion written by the judge who heard the case to which he may file exceptions and seek review by the Court. He receives only the Court's final opinion, from which his sole recourse is to the Courts of Appeal. It is true that he may file, as part of his brief in the Tax Court, proposed findings of fact and conclusions of law. But the import of §8(b) seems clear that a party is to be allowed to file proposed findings prior to the "recommended, initial, or tentative decision" *and* exceptions to such decision upon agency review—not merely proposed findings to a final agency decision. On this phase of the Act, the Attorney General's interpretation seems correct. He says, in his letter to Senator McCarran,[29]

> "Section 8(b): Prior to each recommended, initial, or tentative decision, parties shall have a timely opportunity to submit proposed findings and conclusions, and prior to each decision upon agency review of either the decision of subordinate officers or of the agency's tentative decision, to submit exceptions to the initial, recommended, or tentative decision, as the case may be. * * *"

If the Tax Court were to follow these procedures, a party would have an opportunity to see, and file exceptions to, the report of the hearing judge. That report would be in the nature of an initial or recommended opinion. He would then have an opportunity to file proposed findings before the Court issued its final opinion.

The courts have not yet passed upon the adequacy of Tax Court procedures under the Administrative Proce-

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[29]Legis. Hist., p. 229.

dure Act. In *MacDonald v. Commissioner,* 5 T. C. M. 1098, a family partnership case, the taxpayer filed a motion[30] asking the Tax Court to vacate its findings, opinion, and decision on the ground that the taxpayer had no opportunity prior to the decision to file exceptions or objections as required by section 8 of the Administrative Procedure Act. The Tax Court denied the motion and the taxpayer appealed to the Sixth Circuit Court of Appeals, urging as one ground for reversal the Tax Court's failure to follow proper procedures under the Administrative Procedure Act.[31] The Court of Appeals on December 11, 1947, affirmed the Tax Court without opinion, ignoring the argument based on the Act.[32]

The reason for the Sixth Circuit's "silent treatment" of the Administrative Procedure Act argument in the *MacDonald* case is far from clear, particularly in view of its earlier pronouncements that it regarded the Tax Court as subject to the Act.[33] In any case, it seems certain that taxpayers will continue to present the issue to the various Circuit Courts and perhaps to the Supreme Court, until a definite ruling is obtained.

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[30]See CCH Dec. 15,563(M).

[31]Section 10(e) of the Act provides that the reviewing court shall "hold unlawful and set aside agency action, findings and conclusions found to be * * * without observance of procedure required by law."

[32]484 CCH ¶9110.

[33]*Lincoln Electric v. Commissioner* and *Dawson v. Commissioner, supra,* pp. 8, 9.

3. Judicial Review.

The Supreme Court, in *Dobson v. Commissioner,* 320 U. S. 489, directed appellate courts not to upset Tax Court decisions which had a "warrant in the record" or a "rational basis for the conclusions" reached. Tax Court decisions on "mixed questions" of law and fact were to stand. Only if the Appellate Court could separate the elements of a decision so as to identify a "clear-cut mistake of law" might it reverse the Tax Court.

While perhaps the *Dobson* case was intended originally merely to insure that Tax Court decisions be accorded the same finality on review as decisions of other agencies.[34] application of the *Dobson* rule, in some cases at least, appears to have gone considerably beyond this initial objective.[35] The permissible area of review under *Dobson* is at present certainly narrow but otherwise uncertain.[36]

Section 10(e) of the Administrative Procedure Act provides that the reviewing court shall set aside agency action, findings, and conclusions "unsupported by substantial evidence." It also provides that:

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[34]See *supra,* p. 6.

[35]For the extent to which the principle has been carried, see for example, two Second Circuit cases: *Kirschenbaum v. Commissioner,* 155 F. 2d 23, cert. den. 329 U. S. 726, and *Brooklyn National Corp. v. Commissioner,* 157 F. 2d 450, cert. den. 329 U. S. 733.

[36]See digest of "Dobson" decisions in 484 CCH, ¶1744.25 *et seq.*

"in making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party * * *."[37]

It may be that in some cases application of these provisions would not cause a court to reach a different result from what it would reach without them.[38] It does seem, however, that the Act has to a considerable degree broadened the area of review prescribed by the *Dobson* case and those which followed it. For example, whereas the Act directs the reviewing court to determine whether there is substantial evidence on the whole record to support the agency's findings, the Supreme Court, in *Commissioner v. Scottish-American Investing Co.,* 323 U. S. 119, 124, seemed to say that the reviewing court's function is exhausted when it finds that there is "any substantial basis in evidence" anywhere in the record to support the Tax Court's conclusions.[39] Therefore, it appears

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[37]The House Report, Legis. Hist., p. 279, explains these provisions as follows: "'Substantial evidence' means evidence which on the whole record is clearly substantial, plainly sufficient to support a finding or conclusion * * * and material to the issues. * * * Although the agency must do so in the first instance, under this bill it will be the duty of the courts to determine in the final analysis and in the exercise of their independent judgment whether on the whole of the proofs brought to their attention the evidence in a given instance is sufficiently substantial to support a finding, conclusion or other agency action or inaction."

[38]See *Dawson v. Commissioner* (C.C.A. 6th, decided Sept. 22, 1947); *Lawton v. Commissioner* (C. C. A. 6th, decided Nov. 24, 1947); *Credit Bureau of Greater New York v. Commissioner,* 162 F. 2d 7 (C. C. A. 2d).

[39]"The judicial eye must not in the first instance rove about searching for evidence to support other conflicting inferences and conclusions which the judges or the litigants may consider more reasonable or desirable. *It must cast directly and primarily upon the evidence in support of those made by the Tax Court.*" (Emphasis added.)

that the Sixth Circuit correctly indicated in the *Lincoln Electric* case that within a certain area application of the review provisions of the Administrative Procedure Act would change the result which a reviewing court would otherwise reach. The precise breadth of this area will of course have to await future decisions.

C. The Future.

It may be expected that the Supreme Court will eventually provide the answer to the questions discussed in this article unless legislation first makes an answer unnecessary.[40] Such legislation might specifically and directly exempt the Tax Court from part or all of the provisions of the Act, although this would be a departure from the fundamental approach of the sponsors of the Act, placing exemptions on a functional rather than an agency basis.[41] Or the legislation might take the Tax Court outside the Act by making it a court in fact as well as in name.[42] Such a proposal was embodied in H. R. 3214 introduced

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[40]Even legislation, unless retroactive, may not obviate the need for an answer with respect to pending cases.

[41]See H. R. Rept., Legis. Hist., p. 250. "Functional classifications and exemptions have been made, but in no part of the bill is any agency exempted by name. * * * Where one agency has shown that some particular operation should be exempted from any particular requirement, the same function in all agencies has been exempted. No agency has been favored by special treatment."

[42]See *Williams v. U. S.*, 289 U. S. 553, 565, where the Court says that by the provisions of the Tucker Act "it is made plain that the Court of Claims, originally nothing more than an administrative or advisory body, was converted into a court in fact as well as in name * * *."

in the first session of the eightieth Congress,[43] and similar legislation will probably be introduced in the coming session.

Since the Bar has generally regarded Tax Court procedures as satisfactory, any legislation relating to the Court will probably leave these unchanged. The same is not true of the standard of review accorded Tax Court decisions under the *Dobson* rule. *Dobson* was intended to bestow upon Tax Court decisions the same degree of finality generally accorded determinations of other agencies —not a greater degree.[44] If the Administrative Procedure Act standard of review were to apply to decisions of other agencies, but some lesser standard to Tax Court decisions, the situation would indeed be anomolous. Accordingly, it seems likely that legislation affecting the Tax Court will adopt either the substantial evidence rule of the Administrative Procedure Act, or the standard applied to review of Federal District Court decisions.[45] In either case *Dobson* seems doomed.

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[43]See debate on bill in Cong. Rec., July 7, 1947, pp. 8850 *et seq.*, discussing the effect of the Administrative Procedure Act and the *Lincoln Electric* case on the Dobson rule and the Tax Court procedures. The House passed the bill and sent it to the Senate Judiciary Committee.

[44]See *supra,* p. 6.

[45]Sec. 1294 of H. R. 3214, 80th Cong., 1st sess., would have made Tax Court decisions reviewable "in the same manner and to the same extent as decisions of the District Courts in cases tried without a jury." See, F. R. C. P. 52.